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TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

Date: JAN - 9 2004

UIL 501.00-00

Contact Person:

ID Number:

Telephone Number:

Employer Identification Number:

Dear Applicant:

We have considered your application for recognition of exemption from federal income tax under section 501(a) of the Internal Revenue Code as an organization described in section 501(c)(3). Based on the information submitted, we conclude that you have not established that you are organized or operated exclusively for the exempt purposes described in section 501(c)(3) of the Code. The basis for our conclusion is set forth below.

was organized under the nonprofit laws of on for charitable purposes within the meaning of section 501(c)(3) of the Internal Revenue Code. According to the Articles of Incorporation, is organized exclusively for charitable and educational purposes, including for such purposes,

underlying mission is to promote the display and appreciation of in the vicinity of will spend 95% of its time and resources in the conduct of an annual art show in Artists will be renting booths. The art show provides an opportunity for the public to learn about and acquire the works of artists who work with western wildlife and Native American themes. does not have a shop where it can sell the artwork; it only sponsors this annual art show.

Second, will provide an annual scholarship for art students. solicits from high schools and by news releases in two newspapers. Selection is made on a non-discriminatory basis. Scholarships are not based on employment or income status.

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revenue is generated through booth rentals, which are paid by participating artists who are exhibiting their art work. Furthermore, there is an auction during the art show where will generate 40% commission of the gross sales. Last, generates revenues through the sale of its poster during the show. Beyond the actual art show and its promotion, the organization will not be doing any additional fundraising. Over the past three years, income was \$ for the annual art exhibit. The expenses over this 3-year period were all related to the annual art exhibit or for the scholarship. None of the expenses include compensation to board members.

board is comprised of individuals from the community. None of the board members or directors will be compensated.

APPLICABLE LAW

Section 501(c)(3) of the Internal Revenue Code provides exemption from federal income tax for charitable organizations which are organized and operated exclusively for educational or charitable purposes.

Section 1.501(c)(3)-1(d)(2) of the Income Tax Regulations states that the term "charitable" is used in section 501(c)(3) of the Code in its generally accepted legal sense.

Section 1.501(c)(3)-1(d)(3) of the regulations provides that the term "educational" includes the instruction or training of the individual for the purpose of improving or developing his capabilities and the instruction of the public on subjects useful to the individual and beneficial to the community. Section 1.501(c)(3)-1(d)(3)(ii) of the regulations states that museums are educational organizations.

Section 1.501(c)(3)-1(c)(1) of the regulations states that an organization will be regarded as "operated exclusively" for one or more exempt purposes only if it engages primarily in activities which accomplish one or more of such exempt purposes specified in section 501(c)(3). An organization will not be so regarded if more than an insubstantial part of its activities is not in furtherance of an exempt purpose.

Revenue Ruling 66-178, 1966-1 C.B. 138, granted exemption under section 501(c)(3) to an organization which sponsored a public art exhibit at which the works of unknown but promising artists were selected for viewing by a panel of qualified judges. The organization did not sell or offer the displayed works for sale.

Revenue Ruling 71-395, 1971-2 C.B. 228, denied exemption under section 501(c)(3) to a cooperative art gallery formed and operated by a group of artists for the purpose of exhibiting

and selling their works.

Revenue Ruling 76-152, 1976-1 C.B. 151, denied 501(c)(3) exemption to an organization formed by art patrons to promote community understanding of modern art trends by selecting, exhibiting, and selling works of local artists. The organization retained a commission on sales less than customary commercial charges and not sufficient to cover the cost of operating the gallery. The ruling states that the sale of artworks serves the private interests of those artists whose works are displayed for sale.

In Goldsboro Art League, Inc., v. Commissioner, 75 T.C. 337 (1980), the Tax Court ruled that the organization had as a predominant purpose the maintenance of visual art forms so that it could promote, encourage and educate the public and thus qualified for exemption under section 501(c)(3). The Court concluded that the sales activities of the galleries were "secondary and incidental" to furthering the organization's primary exempt purpose, which was to educate rather than sell.

In Cleveland Creative Arts Guild v. Commissioner, T.C. Memo. 1985-316, the court concluded that an organization similar to the one described in Goldsboro Art League qualified for exemption under section 501(c)(3) even though the organization did not undergo a selection process in determining which artwork was to be displayed. ("Although respondent makes much of the fact that, unlike the petitioner in Goldsboro Art League, Inc., petitioner did not screen the entries for artistic merit, we do not find that the absence of a selection process is necessarily indicative of a commercial purpose, especially in light of the fact that the festivals and shows with which we are concerned here were of short duration, while the petitioner in Goldsboro Art League, Inc. maintained a year-round gallery.")

In Better Business Bureau of Washington, D.C., Inc. v. United States, 326 U.S. 279 (1945), the requirement in section 501(c)(3) that an organization be organized and operated "exclusively" for exempt purposes was construed as meaning that the organization have as its "primary" activity the performance of exempt functions. The Court further held that the presence of a single non-exempt purpose, if substantial in nature, will destroy a claim for exemption regardless of the number or importance of truly exempt purposes.

ANALYSIS

Section 501(c)(3) of the Code sets forth two main tests for qualification for exempt status. An organization must be both organized and operated exclusively for purposes described in section 501(c)(3).

is not organized exclusively for exempt purposes. Articles of Incorporation contain references to section 501(c)(4) of the Code. Although there is some overlap between sections 501(c)(3) and 501(c)(4), not all 501(c)(4) purposes and/or activities are within the scope of section 501(c)(3). Therefore, contributions to organizations described in section 501(c)(4) of the Code would not necessarily further purposes specified in section 501(c)(3) of the Code.

is not operated exclusively for exempt purposes within the meaning of section 501(c)(3) of the Code. The regulations under section 501(c)(3) expand on the requirements for satisfaction of the operational test. The key requirement is that an organization must be operated exclusively for one or more exempt purposes. Section 1.501(c)(3)-1(d)(1)(ii) of the regulations expands on the operated exclusively concept by providing that an organization is not operated exclusively to further exempt purposes unless it serves a public rather than a private interest. Based on the facts that provided in its application for recognition of exemption, even though it is operating for exempt purposes, does not operate exclusively for exempt purposes as it has a substantial nonexempt purpose of helping artists sell their art works at its annual art show.

case is distinguishable from that of Goldsboro Art League, *supra*. In Goldsboro Art League, the organization operated an art center which furnished various educational and charitable services to the community. In connection with the center, the organization also operated two art galleries. The organization accepted paintings and other art works from artists on consignment, set the price at which each work of art would be sold, advertised, and offered the art works for sale, and, following sales, turned approximately 80 percent of the proceeds over to the artists while retaining the remainder to cover expenses.

Several factors appear to have been critical to the favorable ruling in Goldsboro. First, the court stressed the fact that there were no other museums or art galleries in the area; thus, the exhibition of "daring" art works showed a purpose primarily to educate rather than to sell and the selling activity served merely as an incentive to attract artists to exhibit their work. Second, the court thought it important that a jury selected the works to be exhibited and that the works were selected for their representation of modern trends rather than salability. Third, the court was convinced by the record of the organization's "dedication to teach the public, through a variety of means, to appreciate art" and thus that its sales activities were secondary and incidental to furthering its exempt purpose. Thus, where the sales are an integral part and incidental to the declared educational purposes, the activity may be considered a part of the organization's charitable objectives rather than as an end in itself. But here, does not have any significant activities other than the art show, which is oriented toward art sales rather than art education.

activities are also distinguishable from those of Cleveland Creative Arts Guild, supra. In Cleveland Creative Arts Guild, the organization was similarly organized, but its artworks did not undergo a jury selection process. However, the court was not concerned with this issue. ("Although respondent makes much of the fact that, unlike the petitioner in Goldsboro Art League, Inc., petitioner did not screen the entries for artistic merit, we do not find that the absence of a selection process is necessarily indicative of a commercial purpose, especially in light of the fact that the festivals and shows with which we are concerned here were of short duration, while the petitioner in Goldsboro Art League, Inc. maintained a year-round gallery.") The court, however, did emphasize that the organization qualified for tax-exempt status, in part, because there wasn't a nearby museum.

So, both rulings provide exceptions to the revenue rulings that denied tax-exempt status for organizations such as . The exceptions made by the Court in Goldsboro Art League and Cleveland Creative Arts Guild emphasized that there were no other museums or galleries in the area. However, does have a nearby museum, the , which is located only a few miles from location. Therefore, it would be difficult to analogize the organizations described in Goldsboro Art League or Cleveland Creative Arts Guild to the case at hand.

Here, the organization's primary activity is the operation of a selling mart for artists. Essentially, the organization is simply renting space to artists. While does provide scholarships for prospective art students, it must be organized and operated "exclusively" for exempt purposes. The presence of a single non-exempt purpose, if substantial in nature, will destroy a claim for exemption regardless of the number or importance of truly exempt purposes. The non-exempt purposes served by activities are engaging in ordinary commercial activity by renting space to artists and promoting the private interests of artists by aiding them to sell their works. As the Supreme Court stated in Better Business Bureau, supra, the presence of a single non-exempt purpose, if substantial in nature, will destroy a claim for exemption regardless of the number or importance of truly exempt purposes. As the organization has indicated in its application, 95% of its total time spent will be for this specific function, while the other 5% is for issuing a scholarship to a qualified individual. Based on the information submitted, the operation of the art show clearly constitutes a substantial part of the organization's total activities.

Accordingly, the organization is not operated exclusively for educational purposes and thus does not qualify for exemption from Federal income tax under section 501(c)(3) of the Code.

Internal Revenue Service
1111 Constitution Ave, N.W.
Washington, D.C. 20224

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If you have any questions, please contact the person whose name and telephone number are shown in the heading of this letter.

Sincerely,



Marvin Friedlander
Manager, Exempt Organizations
Technical Group 1